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Donald F. Evans
Vice President
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EX PARTE OR LATE FILED

July 29, 1996

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JUL 29 1996
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M. Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 96-98

Dear Mr. Caton:

The attached attached analysis of embedded tandem switch revenue requirement was faxed to Richard Metzger on July 28, 1996. This analysis clearly demonstrates that a calculation of a RIC for tandem switching results in a far lower charge than that which is currently assessed. Removal of transport related costs is the main reason for such a result. In addition, proper application of TSLRIC pricing -- as required by Sections 251 and 252 of the Act -- would further reduce the charge.

Please place a copy of this notice and the attached in the record of this proceeding.

Sincerely,

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Calculation of Revenue Requirement Factor

The objective of calculating a revenue requirement is to relate all expenses to "primary" investments. The traditional "primary" investments (Class B account) are: Information Origination/Termination (IOT - 2310), Cable and Wire Facilities (C&WF - 2410), Central Office Transmission (2230), and Central Office Switching (2210). Primary expenses are those related to the non-investment expenses of Part 36 (separations) Big Three Expense Factor, i.e., Customer Operations Expenses. These expenses include: Marketing (6610) and Customer Services - (6623). Central Office Switching - Operator Systems (2220) and Call Completion (6621) and Number Services (6622) expenses can be treated as primary investment/expenses or associated with all primary investments/expenses. Once the "non-primary" investments/expenses have been allocated to "primary" investments/expenses, the "primary" expenses could be allocated to the "primary" investments to derive a fully distributed cost/"primary" gross investment. Class B accounting is used because Part 36 and therefore the ARMIS 43.04 does not require Class A detail to be used. "Subject to Separations" (Part 32 - Part 64 - SNFA - Other Adjustments) has been used in all calculations.

Bottoms Up

The first step is to allocate the "direct" expenses to the primary investment. Depreciation detail is sufficient to allocate the related depreciation expense to the primary investment. Plant specific expense is allocated per Part 36 and therefore the Plant Specific expenses for the individual Central Office pieces (6210+6220+6230) are allocated to total Central Office investment (2210+2220+2230). This common factor is applied to the individual central office investment pieces. Per Part 36, Network Operations is only allocated between IOT, C&WF and CO. The return amount is calculated at 11.25% based on net investment which is recalculated as a factor based on gross investment. Net investment is equal to gross investment less accumulated depreciation (3100) less deferred taxes (4100+4340). Because taxes are generally related to "profit" or return, the actual reported taxes are equated to the return component of the "primary" + GSF investments

"Primary" + GSF Investment	Depreciation	Plant Specific	Network Operations	Return (11.25%) on Net Investment	Actual Taxes equated to Return
IOT	6560	6310	6530	X	X
C&WF	6560	6410	6530	X	X
CO					
Transmission	6560	6210+6220+6230	6530	X	X
Switching	6560	6210+6220+6230	6530	X	X
Op System	6560	6210+6220+6230	6530	X	X
GSF	6560	6110+6120		X	X

In separations and therefore the ARMIS 43.04, there is no distinction between tandem switching and local switching in the allocation of expenses, return and taxes. Each switching gross investment dollar gets the same amount of "expenses". For switching (and therefore tandem switching too), the individual revenue requirement factors for 1994 TBOC are: depreciation expense - $.095; plant specific expense - $.045; plant nonspecific (network operations) - $.030; return (11.25%) - $.049; and taxes - $..030, for a total of $.249.

Bottoms Up with 8% overheads

To "gross up" for overheads (8%), the plant specific and nonspecific expenses are multiplied by 1.08. From the previous discussion, the plant specific factor ($.045) becomes $.0486 and the plant nonspecific factor ($.030) becomes $.0324. Depreciation ($.095), return ($.049), and taxes ($.030) remains the same for a total of $.2550

Continuation of discussion for fully distributed - FYI only

The second step is to allocate the "Big 3 Expense" separated costs to the "Big 3 Expenses". GSF "costs" were calculated above and include depreciation, plant specific, return and taxes.

Big 3 Expenses	Corporate Operations	GSF "costs"
Plant Specific		
IOT	6710+6720	X
C&WF	6710+6720	X
COE	6710+6720	X
Plant NonSpecific		
Network Operations	6710+6720	X
Customer Operations		
Marketing	6710+6720	X
Telephone Operator	6710+6720	X
Pub Directory Listing	6710+6720	X
Services		
Local Business Office	6710+6720	X
Revenue Accounting	6710+6720	X
Other	6710+6720	X

The third step is to allocate the "operator" expenses (telephone operator and published directory listing) to operator systems investment. Because "operator" expenses are a part of "Big 3 Expenses" there will also be a "loading" for the "Big 3 Expense" separated expenses - Corporate Operations expense and GSF "costs". The fourth step is to allocate the "plant related" Big 3 Expenses (Plant Specific - IOT, C&WF, & CO and Plant NonSpecific - Network Operations) plus the Big 3 Expense separated "loadings" to the related primary investments. The last step is to move the remaining "non-plant related" Big 3 Expenses to the primary investments based on common per gross dollar of investment.

"Primary" Investment	"Operator" Expenses + "loadings"	"Plant related" Big 3 Expense + "loadings"	"Non plant related" Big 3 Expenses + "loadings"
IOT		X	X
C&WF		X	X
CO			
Transmission		X	X
Switching		X	X
Op System	X	X	X

	Bottoms Up - including direct and indirect expenses, return and taxes		
Cat 2 Investment	$	**3,366,292,000**	
Cat 2 Rev Req Factor	$	**0.249**	Includes PI Sp, Dep, PI NSp, Return & Taxes
Cat 2 Revenue Req (RR)	$	838,206,708	
Cat 2 Minutes		155,283,000,000	
Cat 2 RR/Minute	$	0.005398	
Rate	$	0.005398	
Tandem Rate	$	0.001500	
RIC (Rate - Tandem Rate)	$	0.003898	

Based on 1994 TBOC ARMIS - 43.04

Bottoms Up - including direct, 8% overheads, return and taxes

Cat 2 Investment	$	**3,366,292,000**
Cat 2 Rev Req Factor	$	**0.255**
Cat 2 Revenue Req (RR)	$	858,404,460
Cat 2 Minutes		155,283,000,000
Cat 2 RR/Minute	$	0.005528
Rate	$	0.005528
Tandem Rate	$	0.001500
RIC (Rate - Tandem Rate)	$	0.004028

includes PI Sp, PI NSp, and 8% overhead loading based on expenses, Dep, Return, Tax

	To be grossed up	Includes gross up
PI Sp	$ 0.045	$ 0.0486
PI NSp	$ 0.030	$ 0.0324
Dep		$ 0.0950
Return		$ 0.0490
Taxes		$ 0.0300
Total		$ 0.2550

Based on 1994 TBOC ARMIS - 43.04

Bottoms Up - including direct and indirect expenses, return and taxes - Net of SS7 and 800/888 database

Cat 2 Investment	$	3,366,292,000	
Database Investment	$	192,117,927	
Net Cat 2 Investment	$	**3,174,174,073**	
Cat 2 Rev Req Factor	$	**0.249**	includes PI Sp, Dep, PI NSp, Return & Taxes
Net Cat 2 Rev Req	$	790,369,344	
Cat 2 Minutes		155,283,000,000	
Cat 2 RR/Minute	$	0.005090	
Rate	$	0.005090	
Tandem Rate	$	0.001500	
RIC (Rate - Tandem Rate)	$	0.003590	

Based on 1994 TBOC ARMIS - 43.04

Bottoms Up - including direct, 8% overheads, return and taxes - Net of SS7 and 800/888 database

Cat 2 Investment	$	3,366,292,000
Database Investment	$	192,117,927
Net Cat 2 Investment	**$**	**3,174,174,073**
Cat 2 Rev Req Factor	**$**	**0.255**
Net Cat 2 Rev Req	$	809,414,389
Cat 2 Minutes		155,283,000,000
Cat 2 RR/Minute	$	0.005213
Rate	$	0.005213
Tandem Rate	$	0.001500
RIC (Rate - Tandem Rate)	$	0.003713

includes PI Sp, PI NSp, and 8% overhead loading based on expenses, Dep, Return, Tax

	To be grossed up	Includes gross up
PI Sp	$ 0.045	$ 0.0486
PI NSp	$ 0.030	$ 0.0324
Dep		$ 0.0950
Return		$ 0.0490
Taxes		$ 0.0300
Total		$ 0.2550

Based on 1994 TBOC ARMIS - 43.04